



No profits but big returns

The not-for-profit sector in Australia is both more diverse and much bigger in its economic significance than most people realise. It also involves numerous complex issues for directors. Domini Stuart reports.

The economic contribution of the Non For Profit (NFP) sector is easily overlooked. Yet, in the 2000 financial year, non-profit institutions contributed as much as \$30 billion, or 4.7 per cent of GDP. That's a percentage point higher than mining. 600,000 people – almost 7 per cent of the workforce – are employed in the sector, and another 558 million hours contributed by volunteers equates to 285,000 full-time jobs.

Stick a pin in a list of Australia's 700,000 NFPs and you're as likely to find a multi-million dollar national organisation as a handful of local fundraisers. So much for the lingering image of a bunch of cardigan-wearing do-gooders.

“I propose that we are in a period of immense transformation of not-for-profit boards, both in terms of expectations and liabilities, and the capabilities and contributions that directors are expected to be making,” says Peter Kronborg, Executive Chairman of Oppeus Strategic Human Capital Advisors and National Vice President of the Royal Flying Doctor Service (RFDS). “The sector is moving from committed volunteers – albeit individuals with the best of intentions – to more skills-based individuals or total boards. Advanced boards are recognising that they must select first for skills and capabilities rather than select first for commitment and availability.

“In all fundamental respects, the legal liability and obligations for the director of a commercial company and an NFP are the same,” continues Kronborg. “Public shareholding companies do have the extra compliance and shareholder issues, but then NFPs have the complexity of multiple stakeholder management issues in terms of both input and output.

“Input includes the various sources of funds from different government agencies, corporate donations and sponsorship, plus retail or consumer donations, which are complex to manage. Combining professional and volunteer staff is also a fascinating exercise in complexity. A difference in output is the caring relationship between the client and the not-for-profit which transcends a normal commercial relationship; the not-for-profit wants to help and cannot equate the limits of help with simple commercial value.”

According to Gavin Nicholson, Senior Lecturer in the Faculty of Business at the Queensland University of Technology and co-author of *Boards That Work – A New Guide For Directors*, another major difference is the amount of time directors of NFPs need to spend articulating and operationalising the purpose of the organisation.

“In a commercial business you may argue over whether you are going to use EVA, NPV, IRR or some other financial indicator as you benchmark but, at the end of the day, you’re there to make a profit,” he says. “An NFP will generally have some overarching intention or mission, say to help disadvantaged youth, but this immediately raises questions like ‘what is our definition of disadvantaged?’, ‘what is our definition of youth?’. You end up with very curly questions like ‘do we also help parents because of their enormous impact on youth?’. Making decisions about how you will apply your scarce resources to different interpretations of your mission is not easy, particularly when key stakeholders may have different ideas about what you should be doing.”

Riddled with inconsistencies

In her 2004 study of over 1700 NFPs, the University of Melbourne’s Centre for Corporate Law and Securities Regulation researcher Susan Woodward states that the regulatory framework behind Australia’s NFPs is riddled with inconsistencies which are undermining an economically valuable sector. “The legal nature of not-for-profit organisations is even more varied than in the for profit sector,” she says. “Some are incorporated under State based associations legislation, some are incorporated as companies limited by guarantee and there are many large, church-sponsored welfare organisations with no clearly defined identity of their own. This has important implications for accountability, governance and regulation.”

“There is an onerous weight on all directors, both commercial and non profit,” says Michael Traill, former Executive Director of Macquarie Bank’s venture capital arm, Macquarie Direct Investment, and founding CEO of Social Ventures Australia. “Over five years we have moved to a place where there’s such a heavy focus on compliance and governance that we are missing the

forest for the trees in terms of strategy, operations and business performance. Talk to directors on both sides of the fence and they'll tell you that they're weighed down with the tick-the-box compliance issues.

"I'm not saying it's trivial or that some level of governance isn't required, but it is my strong personal view that it has gone to an extreme. You're getting good, smart CEOs who would be ripe for sitting on a board saying 'I'm not going to do that – I'm not going to read through three inches of compliance documentation for a board meeting every month'.

"If I can add value to a company I'd rather catch up with the Chief Executive over a cappuccino in front of a white board to discuss strategy and the operational nuts and bolts. For me that's a much smarter way to use my time and skills than to be stuck around a board table reading compliance stuff."

Like their commercial counterparts, NFPs operating nationally face additional layers of complexity.

"Multiple reporting, multiple states, multiple authorities, reporting to the federal government – there are gains from being national but a lot of these are suboptimised by multiplicities and inconsistencies," says Kronborg.

"Sometimes the compliance and documentation requirements for a grant are such that, if allowed to be charged to the grant, they would fully consume the amount the grant provided," says Steven White, Finance Director of the National Trust of Australia (NSW). "Tax Law needs to recognise the work done by charities and make it easier not harder to carry out our charitable purpose."

Unlike the US, Canada and UK, Australia has no central specialist regulator.

"In the UK there's the Charity Commission," says Professor Myles McGregor-Lowndes, Director of the Centre of Philanthropy at the Queensland University of Technology. "In the US and Canada parts of the revenue service not only deal with tax, they have a broader regulatory focus. In these countries you can also go online and see the returns and financial reporting of the Gates Foundation or any other charitable organisation. There are only very limited ways of doing that here and this perceived lack of transparency and accountability is often commented on in the press."

"I think someone should be held accountable for money taken that has tax implications," says Elaine Henry OAM, Chief Executive Officer of The Smith Family and Chair of Nonprofit Australia. "For me, compliance is about answering the question 'how do you know that an organisation is doing what it said it was going to do with the money?'. Where do we close the feedback loop?"

"If you as an individual give money and believe that results should be obtained as either outcomes or milestones, and the organisation isn't realising these

outcomes, how will they be held accountable for that? In the US you have to put in annual returns. I'm not sure this is a good thing, but at least it's some level of security.

"In Australia there's not even a clear definition of what we're talking about in fundraising – what's an expense and what's not, what's a fundraising activity and what isn't. As a result, we're always comparing apples with oranges. The US is much better at benchmarking, and US investors can get intelligence like who's on the board and how the income is generated without having to wade through annual reports trying to read between the lines."

The question of liability

In the early 90s, the fraudulent activities of their chief executive officer left a national charity A\$97 million in debt. The chairman of the board, a retired plumber, was held liable. The judge took the view that a director is expected to be capable of understanding the company's affairs well enough to form a reasonably informed opinion of its financial capacity.

"Across all sectors many highly committed and able individuals are concerned about the exposure associated with sitting on boards with directors who aren't seriously skilled and experienced," says Kronborg.

Other aspects of the law are also causing potential volunteers to think very carefully before making a commitment.

"Say you are putting on a fete to raise funds," says Professor McGregor-Lowndes "Public liability insurance – if you can get it – is expensive, especially where children are involved. And, by law, not only the NFP but the directors or managers are personally liable. They're not getting paid, they're giving freely, but they personally may be held to account. Not everyone is prepared to take that risk.

"Of course, this doesn't mean that NFPs should be able to do what they like. But we do need to find a balance between personal liability and unfortunate events. There's usually a solution in providing resources to upskill not-for-profit management or volunteer directors so that they can manage risk appropriately. We also need affordable and available insurance."

Professor McGregor-Lowndes suggests that compliance risk catches directors in two ways.

"You have limited resources. And the volunteers, public and press are quick to judge – to jump on any perceived indiscretion. I call this the fallen saint syndrome. While we've come to expect for profits to sail close to the wind or operate just inside the law, directors with NFPs have halos – they're seen as the embodiment of goodness. We expect a lot more of them."

Economies of scale

When public donations are at stake, the cost of managing administrative complexity is an emotive as well as a practical issue. Is there a case for limiting the number of NFPs working in any one area?

“It’s an interesting debate, large versus small,” says Professor McGregor-Lowndes. “On one hand, there can be economies of scale. On the other, NFPs provide a valuable safety valve in civil society. The fact that anyone can start one is one of the basics of democracy. I’d be very reluctant to actively discourage groups of people who want to get together to advocate or make a difference in some way. But there are ways to achieve a compromise by working together.”

Henry sees this as the way of the future.

“One of the most pressing issues is the fact that donors don’t want to pay staff costs,” she says. “They want to contribute to what they call programs. But programs are only delivered through people. Providing support mechanisms in any area – hospitals, universities, welfare organisations – comes at a cost, and donors need to understand that. At the same time, I don’t think it’s viable to have multiple organisations vying for the same outcome. You often end up duplicating administrative costs and the public is very tired of it. If there is one organisation doing it and doing it well, work out partnership arrangement.”

The Smith Family is currently working with the Government as part of the Stronger Families and Communities strategy – a progressive model which Henry believes is starting to change the culture of the sector in this area.

“The Government has made an investment in disadvantaged communities through facilitating partners,” says Henry. “The Smith Family is working in seven of these communities with a focus on children up to five years old. As the facilitating partner we don’t receive the money ourselves, we play a banker role. We also take care of the back room stuff – contracts, recruitment, IT and so on. The actual service delivery comes from small local groups according to the wishes of the community. That means there’s no duplication of effort, backroom or administration, so organisations of all sizes are able to deliver to the best of their ability. I believe that this is the way forward.”

The Smith Family is also testing ways of joining with other NFPs to tap into the sector’s potential buying power.

“Many NFPs are reluctant to collaborate, but there are models which show you can work together on certain levels without giving away your competitive advantage,” Henry continues. “At the moment we’re looking at ways to share backroom costs like travel, IT and stationery.”

The director as fund raiser

Michael Traill points to an American saying known as the Three Gs – Give and Get – Or Get Off. “It’s not necessarily appropriate in the Australian context,” he says, “but we’re kidding ourselves if we think that non profits don’t have a key requirement for effective and strategic fund raising.”

“All NFPs are fighting for the dollar,” says Marketing & Business Development Director of the National Trust of Australia NSW, Alan Smith. “The National Trust is not only vying with more emotive causes, there is a general – and mistaken – assumption that the organisation is government funded. In fact, we receive no ongoing government funding, just the occasional grant which has to be applied for. Our fight is to conserve heritage buildings, collections, the natural environment and our cultural heritage for future generations, and that means we’re sometimes fighting both State and Federal Governments. As a result, we must remain totally independent; we’re dependent on securing ongoing memberships, donations, sponsorships and bequests from the public and the corporate sector.

“People give when they understand the issues – and because they are asked.” Smith continues. “And they’re a lot more likely to donate to someone they know. In this respect, board members who see fundraising as part of the job can be among an NFP’s greatest assets.”

Susan Woodward, who sits on two NFP boards, cautions against taking the point too far. “Many smaller NFPs don’t attract high net worth individuals and, if the ability to raise funds is the only focus, you could miss ensuring the organisation stays true to its mission,” she says. “I believe you need a balance, and that often means including a carer perspective and/or a consumer perspective, ideally where these people have strategic and other skills as well. You need to build a team of people with a mix of skills who have both time and a commitment to the organisation’s core purpose.”

“We also need to be looking at how we can bring innovation from the wider world into the sector,” says Henry. “How we can educate the public about the real value of the sector and the fact that we’ve changed. We need to know how we can get to grips with the big issues - how we as board directors can really get on top of the complexity in this sector.

“There are similarities to the for profit world but inter-relationships and interdependencies make us much more complex. And we won’t bring about the societal change we need unless we take a strategic approach. That means strategic investment, not bits and pieces of grants given to this, that and the other, or simplistic fund raising. We need to see how tools in the financial services sector can be adapted for the NFP world so we can be more strategic in financing. And we need someone setting the agenda for the public so that issues surrounding sector are better understood.

“I’ve heard it said to someone looking for a career as a non-executive director ‘why don’t you start with an NFP’?,” she continues. “I think that’s the wrong way round. We need the best brains, the best strategy, well connected and

highly experienced people. CEOs are wanting people who have run organisations, who've been there, done that and are open to sharing their networks and optimise their skills. As a result, the whole process of getting appropriate people is probably more challenging.”

Would recruitment be easier if directors of NFPs were paid?

For many people with a commercial background who become involved with an NFP, their desire to make a contribution to society; payment would make no difference to their performance. However, in his professional role of recruiting directors, Peter Kronborg is starting to see a rise in the number of NFPs who are prepared to pay for appropriate skills.

“As an example, in Victoria, Government hospitals have sought to generate operational or organisational governance efficiencies by forming a larger networks,” says Kronborg. “As a consequence there are now some very large networks of over \$1 billion. The traditional model of hospital boards is honorary, but the Government has seen it clear to pay directors on these boards in acknowledgement of the risks they shoulder.”

“In the end it's not about the organisation or individuals,” says Elaine Henry. “We need to keep our eyes on the outcome we're looking for. Some people hate talking about social return on investment – they think it's all too much like economic rationalism. But that's exactly what we're after. The major goal for the Smith Family is to put ourselves out of business.”

Breakout box

Finding strength

The The National Nonprofit Roundtable is the first and only advocate for the NFP sector as a whole. Formed in 2004, it has brought together national peak organisations including Jobs Australia, the Australian Council of Social Service, Volunteering Australia, the Federation of Ethnic Communities of Australia, churches and sporting bodies.

According to Elizabeth Cham, Chair of the Advisory Council, the organisation aims to attract greater recognition for NFPs; to modernise laws which, in some cases, date back to 1601; and to look at different ways of financing the sector.

“As a group, we need to stop being complicit about wasting tax payers' money,” continues Cham. “You simply cannot have social change in one or two years, yet we continually have to apply for one 12 month grant after another. There's all of this hand wringing about indigenous issues yet the reality is that you set up a program and two years later, just as you're getting your head above water, the funding is cut.”

The Roundtable is also focused on raising community awareness of the sector's contribution to democracy.

“If one goes as far back as the abolition of slavery, nonprofits have always been involved. More recently we have the example of NFPs mobilising against the hugely wealthy and powerful tobacco industry. At the other end of the scale, the 2005 Giving Australia research project showed that 86 per cent of the population belong to at least one NFP sporting organisation such as a sporting group.

“NFPs intersect every aspect of Australian life. We are so potentially powerful. Yet we have a deficit mentality – we're all fighting for crumbs from the table. The Roundtable is committed to developing a national strategy which will deliver important economic and social contributions to Australia and beyond.”